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IN THE

Supreme Court of the United States

October Term, 1972.

No. 72-1698

IN THE MATTER OF
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor.

BETHLEHEM STEEL CORPORATION,
Petitioner.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Bethlehem Steel Corporation petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals entered in the above case on April 27, 1973.

OPINIONS BELOW.

The opinion of the United States District Court for the Eastern District of Pennsylvania, the Reorganization Court (App. A),[1] is reported at 339 F. Supp. 603. The opinion of the Court of Appeals for the Third Circuit (App. C) is not yet officially reported.

1. References to the Appendices to this petition are designated "App." Reference to the Appendix prepared for the use of the court below and filed herewith are designated by page number followed by "a."

JURISDICTION.

The judgment of the Court of Appeals (App. D) was entered on April 27, 1973. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

1. Whether a set-off completely effected by an adjustment of debts and credits prior to the filing of a petition for reorganization can be set aside by the Reorganization Court in the exercise of its summary jurisdiction as violative of the order approving the petition for reorganization and enjoining set-offs thereafter?

2. Whether, if a carrier sues for freight charges, Section 6(7) of the Interstate Commerce Act forbids a shipper from defending on the basis of money owed to the shipper by the carrier?

STATUTE INVOLVED.

Section 6(7) of the Interstate Commerce Act, 49 U.S.C. § 6(7) provides, in pertinent part, that no carrier shall:

> "* * * charge or demand or collect or receive a greater or less or different compensation for such transportation of passengers or property, or for any service in connection therewith, between the points named in such tariffs than the rates, fares, and charges which are specified in the tariff filed and in effect at the time; nor shall any carrier refund or remit in any manner or by any device any portion of the rates, fares, and charges so specified, nor extend to any shipper or person any privileges or facilities in the transportation of passengers or property, except such as are specified in such tariffs."

STATEMENT.

1. Reorganization Court Proceedings.

On June 21, 1970, Penn Central Transportation Company filed a petition for reorganization under Section 77 of the Bankruptcy Act (3a-4a) and, on the same day, the Reorganization Court entered, *ex parte,* Order No. 1 (5a-16a) approving the petition. Paragraph 10 of Order No. 1 (14a) provided:

> "10. All persons, firms and corporations, holding collateral heretofore pledged by the Debtor as security for its notes or obligations or holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined from selling, converting or otherwise disposing of such collateral, deposit balances or other credits, or any part thereof, or from off-setting the same, or any thereof, against any obligation of the Debtor, until further order of this Court."

On October 14, 1970, the Trustees in Reorganization petitioned for an order directing certain named shippers, including Bethlehem, to pay freight charges allegedly incurred prior to June 21, 1970, without set-off (19a-20a). By motion and answers, the shippers raised various defenses to this petition, including challenges to the summary jurisdiction of the Reorganization Court (42a, 69a, 79a, 92a, 226a, 286a).

A hearing was held on November 30, 1970 (136a-225a), consisting mainly of statements on the jurisdictional issues raised. No evidence was presented on behalf of the Debtor except an affidavit (98a-103a) which had been filed with the Reorganization Court three days prior to the hearing but which had not been served upon the shippers by the date of the hearing.

2. Bethlehem's Position.

In connection with the Reorganization Court's hearing on November 30, 1970, Bethlehem filed an affidavit showing in detail that, unlike the other shippers before the court, Bethlehem had fully exercised, *prior to the filing of the Reorganization Petition,* its right to set off against its obligation to Penn Central the indebtedness of Penn Central to it for steel products sold and delivered. Briefly summarized, the critical facts are as follows (287a-292a):

In 1970, Penn Central began to fall behind in paying its bills to Bethlehem and, by late May 1970, Bethlehem's bills to Penn Central for steel products sold and delivered, totaling $1,900,000, were past maturity, and substantial current billings remained unpaid. Throughout the spring, Bethlehem officials had requested acceleration of payments and the settlement of overdue balances.

Between June 1 and June 9, 1970, Bethlehem shipped materials to Penn Central, having a value of $375,000, and made payments for freight service to Penn Central of $1,047,000, although Bethlehem's invoices to Penn Central were not being paid. During this time period, Penn Central paid less than $30,000 on its overdue accounts to Bethlehem.

In early June, senior executive officers of Bethlehem decided that no further credit would be extended to Penn Central and that Bethlehem's indebtedness for freight services would be applied against Penn Central's indebtedness to Bethlehem. This decision was made known to Penn Central, Penn Central was taken off Bethlehem's "Approved Credit List," and Bethlehem's Accounting Department was ordered to discontinue issuing checks to Penn Central.

On several subsequent occasions during June, Penn Central endeavored to have Bethlehem change this procedure but Bethlehem's decision remained firm. "Contra

notices" were presented to Penn Central to identify freight bills paid by Bethlehem. Such notices are a regular form used by Bethlehem's Credit Department to notify a customer, also a creditor of Bethlehem, that Bethlehem had paid specific invoices of a customer, thereby cancelling the account except for any outstanding balances.

Penn Central did not cancel any order or request that any shipment be deferred notwithstanding the fact that, following June 10, 1970, Bethlehem had discontinued the extension of credit to Penn Central and had applied mature freight bills against amounts due to Bethlehem.

Prior to June 21, 1970, Bethlehem set off approximately $3,400,000 of Penn Central's freight bills against Bethlehem's billings to Penn Central, including an estimated $800,000 representing charges for freight services rendered prior to June 21, 1970, but not yet billed to Bethlehem. As of June 21, 1970, after completion of the set-off, Penn Central remained indebted to Bethlehem for approximately $1,500,000 representing billing for steel products furnished to Penn Central during the first five months of 1970 and claims for loss and damage in transit, overcharges and transit balances incurred prior to June 21, 1970.

Bethlehem has not set off any amount resulting from freight services rendered by Penn Central after June 21, 1970. Between June 21 and November 15, 1970, shortly before the hearing below, Bethlehem paid Penn Central more than $8,500,000 for freight services and such payments are currently aggregating more than $600,000 per week.

3. The Opinion of the Reorganization Court.

On January 31, 1972, the Reorganization Court rendered its opinion (App. A). It noted initially that the Trustees' petition was based on alleged violations of Order

No. 1 and that the basic question was the extent of its summary jurisdiction to control the right to resort to the remedy of set-off. Assuming jurisdiction, the next question was said to be the propriety of "* * * continuing the existing restraints against set-off." The latter statement with reference to "* * * existing restraints * * *" was apparently a reference to Order No. 1. No specific reference was made to the fact that Bethlehem's set-off had been completed prior to the issuance of Order No. 1.

On the question of jurisdiction, the Reorganization Court first adverted to the general principle that a bankruptcy court possessed summary jurisdiction to vindicate the Trustee's claim to property if, at the time of bankruptcy, there was no bona fide dispute concerning the bankrupt's ownership of that property. The Court further held that the bankruptcy court had power to determine whether any substantive dispute as to ownership of property—here, choses in action—existed.

The Court sought the answer to this question in Section 6(7) of the Interstate Commerce Act. As the bankruptcy court read the cases construing that statute, Section 6(7) contained an absolute requirement that freight charges must be paid in money. Payment by check was permissible. And, where a carrier brought suit to recover freight charges, a shipper was permitted to plead or prove, by way of set-off or counterclaim, claims which it may have had against the carrier for loss or damage. On this basis, the Reorganization Court held that a shipper's claim "* * * does not constitute a defense to a carrier's claim for freight charges * * * rather, it is an independent claim which is properly the subject of counterclaim or set-off. * * *" Therefore, the Court held that there was no dispute of substance concerning the existence of an obligation to pay the freight charges involved in this proceeding and that, ac-

cordingly, the Court possessed summary jurisdiction to control Bethlehem's resort to the remedy of set-off.

In dealing with set-offs against claims by Penn Central, other than for service of carriage, the Court recognized that such set-offs executed prior to bankruptcy would defeat the Court's summary jurisdiction. In this connection, the Court also noted: "* * * In addition, of course, such set-offs would be beyond the reach of Order No. 1." Again, no reference was made to the fact that Bethlehem had completed its set-off prior to June 21, 1970.

In determining whether to exercise power to restrain set-offs against freight charges, the Reorganization Court placed principal emphasis on the "* * * cash need of the reorganization * * *" (325a). On the basis of this and other factors, a general order was entered, with leave to the Trustees to submit an appropriate form of further order to implement the views set forth in the opinion. The shippers were enjoined from setting-off against obligations on account of charges for services of carriage arising prior to June 21, 1970 (327a).

4. The Opinion of the Court of Appeals.[2]

The court below affirmed the holding of the Reorganization Court that it possessed the right to exercise summary jurisdiction with respect to the carrier's claim for freight charges. The court below made reference to its earlier opinion in the bank set-off case, *Penn Central Transportation Co. v. First Wisconsin National Bank*, 453 F. 2d 520 (3rd Cir. 1972), *cert. denied*, 408 U. S. 923 (1972), in which it had held that, if there was no bona fide dispute concerning the right in a chose in action "at the time the reorganiza-

2. The opinion below begins with a mistaken factual assumption that all or most of the shippers involved in this proceeding effected set-offs prior to the filing of the petition for reorganization. Only Bethlehem, among the appellants in the court below, had done so.

tion proceedings are instituted," the Reorganization Court could exercise summary jurisdiction with respect to the enforcement of that chose. The question, then, was whether the set-offs involved in this case created a bona fide dispute.

The Court then turned to the Interstate Commerce Act, holding that, under that statute, "* * * freight charges incurred pursuant to a filed tariff are accorded a legally superior status: that of a law." The court below recognized that this Court has held that a shipper was free to counterclaim, in a suit by a carrier to collect freight charges, on the basis of a claim of loss or damage. However, such a counterclaim, according to the opinion below, did not have "* * * the status of legal defenses * * *" which could defeat the right of the railroad in the reorganization setting. In other words, in testing whether summary jurisdiction existed, the inquiry was no longer whether a substantial adverse claim existed, but, rather, whether a "defense" to the carrier's absolute right to collect for freight service existed. The only recognizable "defense" would be a claim that the freight service had been paid for, that it had not been rendered, that the services were charged under an inapplicable tariff schedule or that the rates were unreasonable. On the basis of this reasoning, the court below held that the railroad's choses in action arising out of freight charges were not subject to bona fide disputes because of the presence of other disputes between the railroad and the shipper. Such an "independent claim" by a shipper was merely a matter that "could have been litigated in the railroad's suit for charges had not the intervening structure of the Bankruptcy Act intervened." On this basis, the court below held that at the inception of these proceedings, the carrier's chose in action arising out of freight charges had the same status as the carrier's deposits in the bank set-off cases.

REASONS FOR GRANTING THE WRIT.

This proceeding was instituted by a petition which called upon the Reorganization Court to exercise summary jurisdiction over set-offs which were alleged to be in violation of Paragraph 10 of Order No. 1, issued on June 21, 1970, in the implementation of the petition for reorganization filed on that date. In sustaining the power of the Reorganization Court to exercise summary jurisdiction over Bethlehem's set-off, completed prior to that date, the opinions below either ignored or blurred consideration of the critical time factor. In so doing, the decisions below are in conflict with the result reached in the earlier bank set-off case, *Penn Central Transportation Co. v. National City Bank of Cleveland, Ohio, et al.*, 315 F. Supp. 1281 (1970), *aff'd*, 453 F. 2d 520 (3rd Cir. 1971), *cert. denied*, 408 U. S. 923 (1972), and they constitute an approach to the question of the summary power of a reorganization court which contrasts sharply with that of the Court of Appeals for the Second Circuit in *In The Matter Of The Lehigh and Hudson River Railway Company*, 468 F. 2d 430 (1972).

Further, the decisions below declined to recognize that the carrier's chose in action, the claim for freight charges against Bethlehem, was subject to a substantial adverse claim on Bethlehem's part, and was not property in the constructive possession of the Trustee at the time the petition for reorganization was filed. This conclusion below was reached by translating "substantial adverse claim," the classical and accepted term, into "defense," and assigning a limited meaning to "defense" on the basis of a mechanical interpretation of Section 6(7) of the Interstate Commerce Act and an unwarranted narrow reading of this Court's opinion in *Chicago & N. W. Ry. v. Lindell*, 281 U. S. 14 (1930).

Both issues are of importance. The decisions below, which nullify Bethlehem's set-off, constitute an unwarranted

extension of the already great power of the Reorganization Court. And the interpretation of Section 6(7) renews the inflexible and unrealistic views of decisions that were rejected by this Court in *Lindell.*

1. Bethlehem's Pre-Petition Set-off.

In the bank set-off case, *Penn Central Transportation Co., supra,* the National City Bank of Cleveland had effected a set-off on June 20, 1970, the day before the petition for reorganization was filed and Order No. 1 issued. The Reorganization Court held, as to the set-off by Cleveland Bank, that "* * * no violation of the Order is properly chargeable, * * *" 315 F. Supp. at p. 1285, and that the existence of a substantial adverse claim rendered the question of the validity of the set-off inappropriate for summary disposition. There was no difference whatsoever between the position of the Cleveland Bank and the other banks involved in that case which had attempted set-offs except the timing of the set-off. The Cleveland Bank had done so before the filing of the petition, the other banks after the petition for reorganization was filed. No money was due to any of them by the railroad on the day before the petition was filed. The filing of the petition was, of course, an act of default. But the moment before that petition was filed, insofar as the existence of a "substantial adverse claim" was concerned, the position of all banks was the same. The only real difference was time. The Cleveland Bank effected its set-off before the petition was filed and, on this basis, the Trustees were remitted to a plenary suit.

Here, no violation of Order No. 1 would be chargeable to Bethlehem since Bethlehem had completed its set-off before June 21. Insofar as the question of summary power is concerned, it makes no difference that the bank case involved contempt proceedings and, here, the lesser power

to set aside and turnover was invoked. The source of the power is the same and in neither case does it extend to completed pre-petition set-offs.

The point is well made in *In The Matter of Lehigh and Hudson River Railway Company,* 468 F. 2d 430 (2d Cir. 1972). In that case, Judge Friendly analyzes with precision the nature of the additional summary power of a reorganization court over set-offs, as compared with a court sitting in ordinary bankruptcy. The power has been said to be comparable to that enforced by courts of equity. On this, Judge Friendly's opinion states (468 F. 2d at 433):

> "* * * Since a court of equity normally has summary jurisdiction to punish for contempt of its own orders and consequently to take the less stringent step of directing compliance, it may compel the latter where, as in the cases cited, it was clear that no act of setoff had occurred prior to the bankruptcy."

The opinion goes on to examine and reject the contention that the Reorganization Court's summary powers can be extended to pass on the validity of set-offs made prior to the order enjoining them, citing with approval the decision of the Reorganization Court here involved in its decision in the bank set-off case.

On the basis of the decision in the bank set-off case and on the basis of the analysis made by Judge Friendly in the *Lehigh and Hudson River* case, as to the nature and extent of summary jurisdiction, the courts below should have distinguished Bethlehem's situation from that of the other shippers in the proceeding below and remitted the Trustees to a plenary suit. The law on this point was thought to be settled by *In Re Chicago & Northwestern Railway,* 86 F. 2d 508 (7th Cir. 1936), the decision followed by the

Reorganization Court in the bank case and cited with approval by Judge Friendly in the *Lehigh and Hudson River* case.

2. Bethlehem's Substantial Adverse Claim.

Section 6(7) of the Interstate Commerce Act was enacted to insure that published tariff rates, known to all, were charged for freight carriage services. The purpose of the statute was to condemn secret arrangements whereby the consideration moving to the carrier for freight services became uncertain and not susceptible of precise valuation. The existence of such arrangements had provided techniques for extending rebates and discriminatory treatment to preferred shippers. Such arrangements were condemned in decisions such as *Louisville & Nashville R. R. v. Mottley,* 219 U. S. 467 (1911). Over a period of time, a conflict in decisions developed as to the literalness with which Section 6(7) was to be enforced. Cases such as *C. & N. W. Ry. Co. v. Stein Co.,* 233 Fed. 716 (D. Neb. 1915) took a narrow and mechanical view of the statute, forbidding the pleading of good faith counterclaims in a suit by a carrier even though this meant losing the right of action embodied in the counterclaim as a matter of state law.

Such cases were grouped and disapproved by this Court in the *Chicago & N. W. Ry. v. Lindell,* 281 U. S. 14 (1930). In a suit by a carrier to collect freight charges, the shipper set off damage to the cargo, not seeking affirmative relief but as a set-off. The carrier had contended that the shipper could not plead its loss as a defense but must be relegated to a separate suit. The District Court allowed the set-off and the Court of Appeals for the Ninth Circuit certified the question to this Court.

In affirming the right of set-off, this Court recognized that the purpose of Section 6(7) was to prevent discrimination and to require that freight charges be assessed at the established tariff rate. However, the Court held that there was nothing repugnant to Section 6(7) in permitting shippers to defend suits brought by carriers to collect freight, on the ground of loss or damage. This was said to be "* * * the practical equivalent of charging a judgment obtained in one action against that secured in another. Neither is to be distinguished from payment in money." 281 U. S. at p. 14. The Court recognized that there was always some danger of collusion, whether counterclaims were pleaded in defense or made the subject of a separate action, but that relegating shippers to separate actions would not, in all probability, operate more effectively to enforce the purpose of Congress to prevent discrimination.

The first point to note in *Lindell* was that the shipper sought no affirmative relief but only pleaded its loss as a defense, a set-off against the carrier's claim. There is thus no basis for the attempt by both courts below to read *Lindell* as limited to affirmative counterclaims, this on the assumption that the technical characterization of Bethlehem's substantial adverse claim stands or falls on the niceties of pleading. In short, under *Lindell*, the shipper's counterclaim is a substantial adverse claim, a complete defense.

The reasoning behind the *Lindell* holding is not narrowly confined to particular classes of counterclaims. Where there is no question of preferential treatment but simply the proper adjustment of mutual debts and credits, transactions which constitute payment in money as a matter of commercial practice, set-offs are clearly permissible.

Here there can be no question of subterfuge or secret arrangement. Nor did Bethlehem's set-off involve the

exchange of goods for freight services so as to render uncertain the tariff charges being assessed by the carrier. The set-off involved precise amounts of money on both sides. The precise tariff amount was charged by the carrier. A precise amount of dollars, owed for steel products, was charged by Bethlehem.

Therefore, on the day that the petition for reorganization was filed, Bethlehem, by virtue of a mutual antecedent set-off of balances in place of the exchange of currencies in equal value, owed the carrier nothing.

The substantiality of Bethlehem's position must be measured in terms of a hypothetical suit by the carrier. If such a suit had been brought, there is no question but that Bethlehem's defense on the basis of payments would have been sustained.

As noted by Judge Friendly in the *Lehigh and Hudson River* case, the Reorganization Court's injunction against set-off is "strong medicine," since it means that what amounts to the finest kind of security in ordinary bankruptcy may prove, even with the grant of priority, to be useless. 468 F. 2d at p. 434. Judge Friendly goes on to point out that, even as to set-offs subject to orders such as Order No. 1, the reality is that the obligor is being ordered to pay something as to which he has substantial grounds for contending that he no longer owes when the petition was approved. He concludes that a substantial contention that the set-off was made before it was enjoined should therefore be passed upon in a plenary action.

It is submitted that this is the position here. Bethlehem's claim was substantial, would have prevailed in a suit brought by the carrier to collect freight charges, and should be viewed as beyond the summary jurisdiction of the Reorganization Court.

CONCLUSION.

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

District Court Opinion.

FULLAM, *J.* January 31, 1972

The Trustees of the Debtor have filed a petition for an order directing certain shippers to pay amounts due Debtor. They assert that more than $9 million was due and owing from shippers and receivers on June 21, 1970, the date the petition for reorganization under § 77 of the Bankruptcy Act was filed, for freight service rendered prior to June 21, 1970, and that many of the shippers have offset against the freight charges amounts they claim the Debtor owes them. The Trustees assert that this violates paragraph 10 of Order No. 1, which provides in part:

> "All persons, firms and corporations, . . . holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined . . . from off-setting the same, or any thereof, against any obligation of the Debtor, until further order of this Court."

The present application involves two principal issues: (1) the extent of this Court's jurisdiction to control the right to resort to the remedy of set-off; and (2) assuming jurisdiction is found, the propriety of continuing the existing restraints against set-off.

I. JURISDICTION.

The recent decision of the Court of Appeals in the so-called "bank set-off cases," *In the Matter of Penn Central Transportation Co., Debtor,* First Wisconsin National Bank,

et al., Appellants, Nos. 19340-19346 (3d Cir., December 23, 1971) sets forth the principles governing this Court's jurisdiction to control the exercise of set-off rights and, to a lesser extent, the principles governing the exercise of that control.

The Court of Appeals has reiterated the familiar principle that if, at the time of bankruptcy, there is no bona fide dispute concerning the bankrupt's ownership of property, the bankruptcy court possesses summary jurisdiction to vindicate the Trustees' claim to that property. In the cited case the property was a chose in action, and the Court, applying this general principle, held that the bankruptcy court's determination that there is no substantial dispute as to the bankrupt's ownership of the chose in action establishes the summary jurisdiction of the bankruptcy court. This necessarily implies that the bankruptcy court possesses jurisdiction to determine whether there is a substantial dispute concerning the ownership of the chose in action.

In the present proceeding, the question of whether there is a substantial dispute as to the Debtor's ownership of the chose in action involves not a determination of who is its proper obligee, but rather the determination of whether the chose in action exists. Crucial to this determination is the question of what occurrences prior to bankruptcy could have discharged the railroad's claims for services of carriage.

The Interstate Commerce Act provides the answer. In furtherance of the public policy against discriminatory practices, railroads are strictly regulated in their collection of charges for carriage of freight. 49 U. S. C. A. § 3(a) provides:

> "No carrier by railroad . . . shall deliver or relinquish possession at destination of any freight . . . transported by it until all tariff rates and charges thereon

have been paid, except under such rules and regulations as the Commission may from time to time prescribe to govern the settlement of all such rates and charges and to prevent unjust discrimination. . . ."

By its *ex parte* Order No. 73, originally adopted in 1920, the Interstate Commerce Commission permits a rail carrier to extend credit up to a maximum of 120 hours after delivery of freight, provided adequate precautions are taken to insure payment within that time. 49 C. F. R. § 16(e); *see,* for example, *United States v. Pennsylvania R. R.,* 308 F. Supp. 293 (E. D. Pa. 1969).

SECTION 6(7) of the Interstate Commerce Act provides, *inter alia,* that no carrier shall

". . . charge or demand or collect or receive *a greater or less or different compensation* for such transportation of passengers or property, or for any service in connection therewith . . . nor shall any carrier refund or remit in any manner or by any device any portion of the rates, fares, and charges so specified, *nor extend to any shipper or person any privileges or facilities in the transportation of passengers or property, except such as are specified in such tariffs.*" (Emphasis supplied.)

The Supreme Court has unequivocally held that under this section a carrier may not accept in exchange for its services of carriage anything but money. *Louisville and N. R. R. v. Mottley,* 219 U. S. 467, 477, 479 (1911); *Chicago, I. and L. R. R. v. United States,* 219 U. S. 486, 496 (1911); *Fullerton Lumber Co. v. Chicago M., St. P. and Pac. R. R.,* 282 U. S. 520 (1931). The Court has, however, sanctioned payment by check as the equivalent of payment in money, *Fullerton Lumber Co. v. Chicago, M., St. P. and Pac. R. R.,*

supra; and, where a carrier brings suit to recover freight charges, has permitted a shipper to plead and prove, by way of set-off or counterclaim, claims which it may have against the shipper for loss and damage, etc. *Chicago and N. R. R. v. Lindell,* 281 U. S. 14 (1930). But these are the only permitted variations on the general rule set forth in *Mottley* that no deviations from the provisions of the published tariff are permitted. *Mottley, supra,* at 477. *See Northeast Airlines, Inc. v. C. A. B.,* 345 F. 2d 662, 666-68 (1st Cir. 1969).

In applying the foregoing principles to the resolution of the preliminary jurisdictional issue in the present case, it is necessary to differentiate among various respondent-shippers according to the grounds on which their claims are based. Four general categories appear:

1. Certain shippers contend they have overpaid earlier bills or mistakenly paid erroneous or duplicative bills. Included among these are Chrysler Corporation and General Electric Company. In essence, these shippers assert that they have not set off, they have paid in money. Such a claim, to the extent it is non-frivolous, presents a substantial dispute as to the existence of the railroad's chose in action. Therefore, the summary jurisdiction of this Court does not extend to a determination of the issues as to these parties unless by their consent.

2. Certain shippers contend that the Debtor has retained the proceeds from the salvage of damaged goods belonging to the shippers. Included in this category are Massachusetts Lumber Company and Thomas J. Holt Company. To the extent it is non-frivolously asserted that the Debtor has received money in this manner, I conclude that this Court, just as in category 1 above, lacks summary jurisdiction to determine the issues between the Debtor and these shippers.

However, the receipt of cash or its equivalent by the Debtor must be distinguished from the assertion against the Debtor of a claim for loss and damage or for materials supplied. As set forth previously, the assertion of such claims by a shipper cannot constitute payment for freight charges.

A shipper's claim does not constitute a defense to a carrier's claim for freight charges. *Southern Pacific Co. v. Miller Abattoir Co.*, No. 19,516 (3d Cir., January 12, 1972), slip opinion at 8. Rather, it is an independent claim which is properly the subject of counterclaim or set-off. Whether a shipper should be permitted, at this time, to obtain payment on an independent claim through the remedial device of set-off is, of course, the ultimate issue to be determined in this case. In any event, there is no dispute of substance concerning the existence of an obligation to pay the freight charges and, accordingly, this Court possesses summary jurisdiction to control the shippers' resort to the remedy of set-off.

3. Another group of shippers contend that, prior to bankruptcy, there was an agreed settlement of mutual accounts between the Debtor and the shipper, with the result that the Debtor either owes money to the shippers, or is owed much less than is now being claimed by the Trustees. Among the shippers in this category are Standard Builders Supply Company, North American Coal Corporation, Thomas J. Holt Company, and to some extent at least, Bethlehem Steel Corporation. To the extent that the Debtor's claims against these companies were based on freight charges, it is clear under the principles set forth previously that they were incapable of being discharged either by unilateral set-off or by mutual agreement. Therefore, again, this Court possesses summary

jurisdiction to control the exercise of the right of set-off against these claims.

4. A final group of shippers appear not to be "shippers" at all, but rather companies which exchange with the Debtor goods or services not involving the carriage of freight. It is claimed that there are formal or informal contractual arrangements under which, from time to time, the parties would "net-out" mutual debts and credits and the resulting balance would be paid. In this category are Mindlin Company, David J. Joseph Company and General American Transportation Company. To the extent that these companies are not obligated to the Debtor for freight charges, the Debtor and the companies were free to agree on what would constitute payment of the obligations. To the extent such payments of the Debtor's claims are nonfrivously asserted, this Court lacks summary jurisdiction to control set-offs against those claims.

Similarly, set-offs (against claims other than for services of carriage) fully executed prior to bankruptcy and adequately documented (for example, by vouchers, credit memoranda and the like) would defeat this Court's jurisdiction. *Megan v. Continental Illinois Nat. Bank and Trust Co.*, 86 F. Supp. 508 (7th Cir. 1936); *Penn Central Transportation Co. v. National City Bank*, 315 F. Supp. 1281 (E. D. Pa. 1970). In addition, of course, such set-offs would be beyond the reach of Order No. 1.

II. Restraint of Set-Offs.

Having concluded that the existence of claims against the Debtor does not exonerate the Debtor from its obligation to collect freight charges in cash or equivalent, but that, in the absence of bankruptcy, such claims against the Debtor can be set up by way of defense in actions brought

by the Debtor to collect its freight charges, I turn now to the question of whether this Court should deprive the shippers of this procedural right, and relegate them to the proof of claim program. The existence of the power to enjoin set-offs has been confirmed by the recent decision of the Third Circuit in the bank set-off cases, *supra;* however, the exercise of discretion is not free from difficulty.

On the one hand, it appears probable that virtually all of the claims giving rise to the attempted set-offs are high priority claims, closely related to the day-to-day operation of the railroad. Moreover, a railroad which does not maintain good relationships with its shippers may quickly lose valuable customers.

On the other hand, post-bankruptcy obligations in this category are being paid on a current basis, and denial of the right of set-off with respect to pre-bankruptcy claims would, of course, be without prejudice to the recognition of the appropriate priority of such claims in the ultimate reorganization of the Debtor.

In my judgment, there are three considerations of particular importance in deciding this question. One is the desirability of treating all pre-bankruptcy claims of the same class in the same way. To permit the set-offs here claimed would be to discriminate against the vast majority of shippers, who have paid their pre-bankruptcy freight claims in full, either because they did not happen to have countervailing claims against the Debtor, or because they conscientiously recognized the strictures of the Interstate Commerce Act and *ex parte* Order No. 73 of Commission.

Moreover, the cash need of the reorganization must be considered. As of the time of the hearing on November 30, 1970, it appeared that set-offs aggregating nearly $9,000,000 were being asserted. More importantly, there is record

basis for supposing that, as of October 26, 1970, pre-bankruptcy claims for freight loss and damage aggregating approximately $19,000,000 had been verified. See the petition (since withdrawn) for authority to pay certain freight loss and damage claims (Document No. 616). While the results of the proof of claim program are still being tabulated and have not been made a part of the official record, the Court is advised informally that proofs of claim for pre-bankruptcy freight loss and damage may exceed $45,000,000 in amount. It is more nearly consistent with the overall purposes of Section 77 that these claims should all be disposed of in the normal course of the reorganization proceeding, rather than that the current operating revenues of the Debtor should be jeopardized by permitting set-offs.

The third factor weighing heavily in the balance is that the Trustees, in the exercise of their mature business judgment, recognizing their obligation to treat all parties fairly, have requested that set-offs be restrained. Given the fact that the Debtor is not yet able to pay even its current real estate taxes or leased line obligations, the Trustees' judgment as to the most equitable course to follow is, in my opinion, correct. Set-offs should not be permitted at this time.

III. Remedy.

Entry of a specific order is not feasible on the present record. In view of the lapse of time,[1] it is probable that many of the respondent shippers originally named have since paid their accounts. Moreover, the present record does not afford an adequate basis for determining which of the respondent shippers may properly claim that they have

1. Disposition of this matter was postponed pending the decision of the Court of Appeals in the bank set-off cases, cited in the text.

paid their freight claims, as distinguished from merely asserting a countervailing claim of their own. Accordingly, an order in general terms will be entered, with leave to the Trustees to submit an appropriate form of further order or orders to implement the views herein set forth.

APPENDIX B.

District Court Order No. 571.

AND Now, this 31st day of January, 1972, it is ORDERED that the petition of the Trustees for an order directing shippers to pay amounts due Debtor (Document No. 400) is GRANTED IN PART, and all persons, firms and corporations served with a copy of said petition are enjoined, until further order of this Court, from setting off or attempting to set-off against obligations due and owing to the Debtor on account of charges for services of carriage any claim or claims which they may have against the Debtor, arising prior to June 21, 1970, but any such claim or claims may be filed and proved in accordance with Order No. 164 in this proceeding. This Order shall be deemed to be without prejudice to the right of any such shipper to claim such priority as may be proper.

JOHN P. FULLAM, *J.*

APPENDIX C.

Court of Appeals Opinion.

(Filed April 27, 1973.)

SEITZ, *Chief Judge.*

The basic issue presented on this appeal is whether a reorganization court in a Chapter 77 proceeding has summary jurisdiction to enjoin a non-judicial set-off of claims for goods, services, and shipping losses and damages against freight charges, where such set-offs were effected prior to the Debtor's filing for reorganization.

The dispute arises out of a petition filed by the railroad trustees. The petition requested the court to issue an order directing certain shippers, including appellants, to pay bills still outstanding for pre-reorganization freight services, i.e., for charges incurred prior to June 21, 1970. Appellants filed answers and briefs asserting the right of set-off against these charges; these set-offs involved claims on charges for supplies and freight loss and damage claims arising during the period prior to the commencement of the reorganization proceedings.[1] Appellants contend that the amount of these set-offs exceeded the amounts owed for freight charges.

Although an affidavit was filed by the trustees alleging the amounts due them, the hearing below focused relatively little upon the validity of these amounts. Rather, it consisted almost entirely of oral argument on whether the re-

1. One appellant's answer does not assert a pre-reorganization set-off. Another's answer does not clearly indicate that an attempted set-off was made before the filing of the reorganization petition. In view of our disposition of this appeal, we need not consider the effect of these variations.

organization court's summary jurisdiction as to these claims was defeated by the presence of appellant shippers' competing claims. After hearing argument on this latter point, the court determined it had summary jurisdiction and entered an order enjoining any set-off by appellants against monies owed by them for pre-reorganization freight charges. However, it deferred ruling on the amount of those charges still outstanding. This appeal followed.

Two conclusions were basic to the court's determination that it had summary jurisdiction over this controversy. First, it concluded that a regulated carrier's freight charges constitute a chose in action. Secondly, it concluded that under §§ 3(1) and 6(7) of the Interstate Commerce Act [49 U. S. C. §§ 3(1) & 6(7) (1971)], a shipper's claims against the carrier are not a defense to the carrier's claim for freight charges due. Therefore, since appellant shippers did not assert colorable adverse claims to the Debtor's choses in action, the court determined that it had the right to exercise summary jurisdiction with respect to the carrier's claims for freight charges.

The court's determination was based upon the holding of this circuit in *Matter of Penn Central Transportation Company*, 453 F. 2d 520 (1972).[2] There we held that where there is no bona fide dispute concerning the Debtor's right in a chose in action at the time reorganization proceedings are instituted, the reorganization court can exercise summary jurisdiction under the statute with respect to the enforcement of that chose. Therefore, assuming the freight charges owed can be conclusively established on remand, the issue for our resolution becomes whether the pre-reorganization set-offs effected by appellants in settlement of their claims created a bona fide dispute as to the Debtor's

2. Hereinafter cited as Bank Cases.

legal entitlement to the freight charges previous to the filing of the reorganization petition.[3]

Under the Interstate Commerce Act, freight charges incurred pursuant to a filed tariff are accorded a legally superior status: that of a law. The only defense which can be raised to a carrier's suit for these legal charges is that the services have been paid for, that the services were not rendered, that the services were charged under an inapplicable tariff schedule, or that the rates were unreasonable.

The purpose of this limitation on defenses to an action by a carrier was to prevent secret kickbacks and preferences between large shippers and carriers. Thus, a set-off for damages incurred in shipment is not considered a defense since the potential for effecting preferences under such a guise seemed manifest. Similarly, a shipper and carrier cannot make provision for the supplying of goods and/or services in exchange for carriage. See, *e.g., Northeast Airlines v. CAB,* 345 F. 2d 662 (1st Cir. 1965). Complementing this statutory scheme was a provision mandating that freight was not to be delivered until paid for in order to prevent the giving of preferences through the extension of credit. 49 U. S. C. § 2 (1971). Present Interstate Commerce Commission regulations in fact require a carrier to institute suit promptly if payment for freight charges is not made within ten days. Therefore, freight tariffs are accorded a special legal status which make inapplicable analogy to normal rules of commercial law.

Appellants rely principally upon the Supreme Court's opinion in *Chicago & N. W. Ry. v. Lindell,* 281 U. S. 14

3. One appellant argues that because there was allegedly an effective non-judicial set-off before these proceedings were instituted, there was no property of the debtor in that appellant's possession at the inception of the reorganization proceedings. We view that argument as but another formulation of the basic issue posed as to the reorganization status of the appellants' claims.

(1930). There, as here, a carrier sued to collect freight charges; the shipper counterclaimed, asserting a loss due to the carrier's failure to perform under the shipping contract. The Court allowed the counterclaim to be asserted against the carrier in the same action, stating:

> The adjudication in one suit of the respective claims of plaintiff and defendant is the practical equivalent of charging a judgment obtained in one action against that secured in another. Neither is to be distinguished from payment in money.

281 U. S. at 17. The Court justified its position as not being in contravention of the Interstate Commerce Act by concluding that it would be a matter of judicial economy to allow the suit: having both parties before the court, it would be most economical to have the court adjudicate the various controversies between those parties in one proceeding. The court would serve to ensure that in fact such suits were not products of collusive agreements designed to thwart the prohibitions of the Interstate Commerce Act.

Although it is clear from *Lindell* that a counterclaim can be asserted against a carrier's suit for freight charges, our court has reiterated that under the Interstate Commerce Act, the subject matter of the counterclaim is not a defense to the carrier's claim for freight charges. Rather, it constitutes an independent claim. *Southern Pacific Co. v. Miller Abattoir Co.*, 454 F. 2d 357 (3d Cir. 1972). Its assertion by means of counterclaim is justified because the court can ensure that it does not result in a circumvention of the Act and because it does further the administration of justice.

The remaining question posed is whether the intervention of reorganization proceedings creates a different

situation. The district court implicitly assumed that while a counterclaim or set-off can be asserted against the carrier in a suit for collection of outstanding freight charges, it cannot be similarly recognized when a carrier seeks enforcement of its claim in a reorganization proceeding. We agree. Because the subject matter of the set-off or counterclaim does not constitute a defense to the carrier's freight claim, the intervention of reorganization proceedings forces analysis of different considerations. Since the Bankruptcy Act sets up a different process for disposition of creditor's claims, we do not believe these shippers' claims, which do not have the status of legal defenses, can defeat the right of the railroad to collect absolutely all legal charges for freight services outstanding and unpaid. Thus, at the inception of these proceedings, the carrier's choses in action arising out of freight charges had the same status as the carrier's deposits in the Bank Cases[4] and were therefore not subject to a bona fide dispute because of the presence of other disputes between the Debtor and the holder of Debtor's chose in action. Appellants merely had an independent claim against the debtor which could have been litigated in the railroad's suit for charges had not the supervening structure of the Bankruptcy Act intervened.

One final issue raised by one of the appellants remains for disposition. It contends that under applicable Pennsylvania law, it extinguished its debt to the railroad by the non-judicial set-off of a debt owed to it by the carrier, citing 12 P. S. § 60 (1953). Even assuming the validity of appellant's contention under Pennsylvania law, such a set-off would have been in express contravention of the Interstate Commerce Act. Indeed, the Act was so designed to prevent the kind of secret kickbacks which this type of practice could lead to. We believe our conclusion not only

4. We do not necessarily approve all the authority cited in this opinion.

comports with the Supremacy Clause of the Constitution but in so doing, does not conflict with any other constitutional provision nor results in the granting of an unwarranted preference to other creditors.

Therefore, we conclude the district court correctly determined in the first instance that it had summary jurisdiction over these disputes and had the power to enjoin their set-off. However, on remand, the court must require the Debtor to attempt to establish the amounts owing by clear and convincing evidence. *Maggio v. Zeitz*, 333 U. S. 56 (1948). The court must then afford appellants an opportunity to challenge those amounts. Only then will the reorganization court be able to determine whether there is such a bona fide dispute and defense to Debtor's claim for freight services as will defeat its exercise of summary jurisdiction.

Given our conclusion that the reorganization court will have the right to exercise summary jurisdiction if the proper showing is made on remand, it follows that it can also exercise its sound discretion, once again, in determining whether or not to permit set-off or counterclaim against the Debtor's charges. This procedure was approved by this court in the Bank Cases. Our disposition of this case renders it unnecessary to decide the other contentions raised by the parties.

The order of the district court will be affirmed and the matter remanded to the district court for further proceedings consistent with this opinion.

APPENDIX D.

Court of Appeals Judgment.

(D. C. No. B-70-347 In Bankruptcy)

On Appeal From the United States District Court for the Eastern District of Pennsylvania.

Present: Seitz, *Chief Judge* and Aldisert, *Circuit Judge* and Lacey, *District Judge.*

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed January 31, 1972, be, and the same is hereby affirmed, and the cause remanded to the said District Court for further proceedings consistent with the opinion of this Court. Costs taxed against appellants.

Attest:

Thomas F. Quinn,
Clerk.

April 27, 1973.